DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 08-0623
Sales and Use Tax
For the Tax Years 2005-2007

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ISSUES

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-1-27; IC § 6-2.5-3-2(a); IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-4-1(e); IC § 6-2.5-4-9(a); IC § 6-8.1-5-1(b); IC § 6-8.1-5-1(c); 45 IAC 2.2-3-7; 45 IAC 2.2-3-8(a); 45 IAC 2.2-3-9; 45 IAC 2.2-3-9(c); 45 IAC 2.2-3-9(e); 45 IAC 2.2-4-1(b)(3); Sales Tax Information Bulletin 60 (July 2006); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of use tax on some items.

II. Tax Administration – Ten Percent Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation engaged in the business of building homes. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional use tax and assessed negligence penalties and interest for the tax years 2005, 2006, and 2007. Taxpayer purchased items for installation in the homes Taxpayer constructed. The Department found that Taxpayer had neither paid sales tax at the time of purchase nor remitted use tax to the Department on these purchases. Taxpayer protested this imposition of use tax and penalties. An administrative hearing was held, and this Letter of Finding results.

I. Sales and Use Tax – Imposition.

DISCUSSION

All tax assessments are presumed to be accurate. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made. IC § 6-8.1-5-1(b), (c); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Furthermore, 45 IAC 2.2-3-9(c) states that "[a] contractor has the burden of proof to establish exempt sale or use when construction material, which was acquired tax-free, is not subject to either the state gross retail or use tax upon disposition."

IC § 6-2.5-3-2(a) provides, "An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

IC § 6-2.5-1-2(a) defines a "retail transaction" to mean:

"Retail transaction" means a transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-1, that constitutes making a wholesale sale as described in IC 6-2.5-4-2, or that is described in any other section of IC 6-2.5-4.

IC § 6-2.5-4-1 defines "retail merchant" and "selling at retail" in part:

(a) A person is a retail merchant making a retail transaction when he engages in selling at retail.

(b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:

(1) acquires tangible personal property for the purpose of resale; and

(2) transfers that property to another person for consideration.

(c) For purposes of determining what constitutes selling at retail, it does not matter whether:

(1) the property is transferred in the same form as when it was acquired;

(2) the property is transferred alone or in conjunction with other property or services; or

(3) the property is transferred conditionally or otherwise.

IC § 6-2.5-1-27 defines "tangible personal property" for sales and use tax purposes as:

personal property that:

(1) can be seen, weighed, measured, felt, or touched; or

(2) is in any other manner perceptible to the senses.

The term includes electricity, water, gas, steam, and prewritten computer software.

Taxpayer purchased cabinets, vanities, marble countertops, sinks, toilets, and other items from a vendor. These items are considered "tangible personal property" pursuant to IC § 6-2.5-1-27.

With regards to property that is purchased in order to be added to a structure or facility, IC § 6-2.5-4-9(a) states that:

(a) A person is a retail merchant making a retail transaction when the person sells tangible personal property which:

(1) is to be added to a structure or facility by the purchaser; and

(2) after its addition to the structure or facility, would become a part of the real estate on which the structure or facility is located.

Since Taxpayer did not pay sales tax at the time of purchase of the items (sinks, cabinets, etc.), the Department assessed use tax on the purchases. 45 IAC 2.2-3-9 states in relevant part that:

(a) A contractor may purchase construction material exempt from the state gross retail tax only if he issues either an exemption certificate or a direct pay certificate to the seller at the time of purchase.

(b) A contractor who purchases construction material exempt from the state gross retail tax or otherwise acquires construction material "tax-free", is accountable to the Department of Revenue for the state gross retail tax when he disposes of such property.

. . .

(e) Disposition subject to the use tax. With respect to construction materials a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:

(1) He converts the construction material into realty on land he owns and then sells the improved real estate;

(2) He utilizes the construction material for his own benefit; or

(3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

45 IAC 2.2-3-7 defines "contractors" and "construction material" as:

(a) Contractors. For purposes of this regulation [45 IAC 2.2] "contractor" means any person engaged in converting construction material into realty. The term "contractor" refers to general or prime contractors, subcontractors, and specialty contractors, including but not limited to persons engaged in building, cement work, carpentry, plumbing, heating, electrical work, roofing, wrecking, excavating, plastering, tile and road construction.

(b) Construction material. For purposes of this regulation [45 IAC 2.2], "construction material" means any tangible personal property to be used for incorporation in or improvement of a facility or structure constituting or becoming part of the land on which such facility or structure is situated.

Taxpayer is a contractor, and the items purchased (sinks, cabinets, etc.) are construction materials.

With regards to 45 IAC 2.2-3-9(e), Taxpayer either converted the items into realty it owned as a homebuilder in order to improve the real estate, or converted the items into realty it did not own but upon which he was constructing real property pursuant to a lump sum contract. In either case, since Taxpayer purchased the items without paying sales tax, it now owes use tax.

The fact that the tangible personal property was incorporated into real property does not relieve Taxpayer of its obligation. 45 IAC 2.2-3-8(a) states that even though, "[i]n general, all sales of tangible personal property are taxable, and all sales of real property are not taxable," Taxpayer would still owe use tax because "[t]he conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property."

Some of the items that Taxpayer purchased from the aforementioned vendor were custom made for the Taxpayer based on the Taxpayer's specifications. Taxpayer asserts that the vendor is a "specialty contractor" and that the custom items that it purchases from this vendor are built pursuant to a lump sum contract. Although there was admittedly no written contract during the tax period at issue, Taxpayer contends that there was a verbal lump sum contract between Taxpayer and the vendor. Taxpayer explains that a call would be made to the vendor, the area for the cabinets would be measured, the types of materials would be selected, and then the vendor would give their quoted price, which Taxpayer states is "all inclusive for the cabinets and installation."

There are two recognized types of contracts by which a retail merchant sells property. Sales Tax Information Bulletin 60 (July 2006) defines a "lump sum contract" as "a contract in which all of charges are quoted as a single price. A construction contractor may furnish a breakdown of the charges for labor, material and other items without changing the nature of the lump sum contract." A "time and materials contract" is defined as "a contract in which all charges for labor, construction materials and other items are separately stated."

However, it really is not an issue if the custom items were built pursuant to a lump-sum contract or a time and materials contract. The fact of the matter is that tangible personal property was purchased by Taxpayer, sales tax was not paid at the time of purchase, and Taxpayer now owes use tax on the purchased items. It does not matter under what type of contract these custom items were built, because in either case, sales tax was due to the retail merchant at the time of their purchase. See IC § 6-2.5-4-1(e) and 45 IAC 2.2-4-1(b)(3).

Taxpayer also proposed that the vendor paid sales tax on all of the materials that the vendor purchased in order to make the custom items for Taxpayer, and therefore, since tax had already been paid by the vendor, Taxpayer did not owe tax on the custom items purchased from the vendor. Taxpayer also stated that a letter was supposed to be sent from the vendor's accountant attesting to this supposition, but the Department never received such a letter. However, even if that were the case, the vendor's wrongful payment of sales tax would not relieve Taxpayer of its obligation to pay the Department the assessed use tax. Taxpayer and the vendor engaged in a transaction subject to sales and use tax. Taxpayer's obligation to pay sales and use tax arose at the time of Taxpayer's purchase of the items.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Ten Percent Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at 45 IAC 15-11-2(c) as follows:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
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> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has not established that its failure to pay the assessed tax was due to reasonable cause rather than negligence.

FINDING

Taxpayer's protest to the imposition of the penalty is denied.

CONCLUSION

In summary, Taxpayer's protests of Issue I and Issue II are denied.

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